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GENERAL AGREEMENT ON TARIFFS AND TRADE

Committee on Balance-of-Payments Restrictions

REPORT ON CONSULTATION WITH ISRAEL AND EXAMINATION OF THE ISRAEL TEMPORARY IMPORT SURCHARGE

1. On 29 September 1970 the Council was informed by the delegation of Israel that the Government of Israel had introduced a temporary import surcharge (see L/3433 and Add.1). The Council agreed that the measure should be referred to the Committee on Balance-of-Payments Restrictions for early examination in relation to the relevant provisions of the General Agreement (C/M/64). The Committee has examined the measure in conjunction with the regular consultation with Israel on its balance-of-payments import restrictions, which took place on 9 March 1971. Part I of the present report summarizes the main points of the discussion in the course of the regular consultation. Part II sets forth the Committee's views concerning the import surcharge.

2. The Committee had before it a basic document supplied by the Israel authorities (BOP/114, Adds. 1 and 2), a background paper supplied by the International Monetary Fund dated 27 January 1971 and the IMF Board Decision of 24 February 1971. It generally followed the plan for such consultations as set forth in L/3388, Annex I.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the IMF to consult with them in connexion with the consultation with Israel. Upon the invitation of the Committee the representative of the IMF made a statement as follows:

> "The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of February 24, 1971 taken at the conclusion of its most recent Article XIV consultation with Israel, and particularly to paragraphs 3 and 4 which read as follows:
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> > '3. During 1969 and 1970, a large number of measures were taken in both the fiscal and monetary fields to reduce demand pressures. These policies played an important role in dampening the economy at a time when public expenditure was increasing strongly. In addition, the increase in wage rates that was agreed in early 1970 took a form that reduced the impact on private consumption. The authorities believe that it continues to be necessary to restrain the growth of internal demand, and for 1971 it is intended that the increase in the money supply will be less than the increase in nominal output and that the Government's recourse to the Bank of Israel for the

budget will be limited to I£ 650 million, the same as in the current fiscal year. The authorities anticipate that the increase in real expenditure will be lower and the increase in prices during the year will be substantially less than in 1970. While welcoming the measures already taken the Fund believes that, in light of continuing pressures on the balance of payments and prices, it is essential to continue a restraining monetary and fiscal policy during 1971.'

'4. The maintenance of liberal trade and payments policies is a key factor for further sound growth of the Israel economy. But although the long-term policy of tariff reduction was continued and tariff rates were accordingly reduced at the beginning of 1970 and 1971, the trade and payments system became less liberal in 1970 in a number of other respects. In particular, a system of prior import deposits and an import surcharge were introduced, the tax on foreign travel was increased, and the allocation of exchange for foreign travel was reduced substantially. At the end of 1970, it was decided to abolish the system of import deposits gradually. Subsequently, deposits were reduced, as of January 1971 from 50 to 40 per cent of the value of imports, with a further reduction to be considered by the end of 1971. A strengthening of the balance of payments position, which is an important objective of the Government, will materially help in reversing this trend. The Fund welcomes the termination of one further bilateral payments agreement with a Fund member and notes that Israel intends to terminate the two remaining agreements as soon as practicable.'

"At the present time the general level of restrictions and the import surcharge of Israel which are under reference do not go beyond the extent necessary to stop a serious decline in its monetary reserves."

I. CONSULTATION ON IMPORT RESTRICTIONS

Opening statement by the representative of Israel

4. In his opening statement, the text of which is annexed to the present report, the representative of Israel referred to the enormous deficit of $1.3 billion on goods and services account in 1970 which arose mainly from expenditures connected with national security and to which must be added the debt service obligations of some $450 million. Faced with this situation and unwilling to revert to restrictive administrative controls the Israel Government had decided to resort to new and more stringent fiscal and monetary measures. When, in August 1970, it became evident that the measures which the Government had reported to the Committee at the last consultation in April 1970 were still insufficient to restrain the outflow of foreign exchange, a further series of stringent monetary and fiscal measures was taken, including an import surcharge. As a result of all these measures the expansion of consumer goods imports was brought to a halt though total imports continued to rise. In this way Israel had refrained from re-introducing quantitative restrictions and in spite of the critical economic circumstances had continued to pursue the programme of liberalization.

5. In the long run the Israel authorities were aware that given the country's dependence on foreign trade and its need to expand exports, the value of imports would have to be determined by the capacity to export and therefore incurring foreign debts and attracting foreign investment could only be justified if it led to an increase of export earnings. From this point of view, the agreement between Israel and the European Economic Community recently submitted to the CONTRACTING PARTIES was of paramount importance for Israel's economy. Furthermore, great efforts had been made to promote exports to the United States (Israel's second largest market) and to her growing and potentially important markets in the Mediterranean area and in countries directly accessible through the Red Sea outlet. Like other members of the Committee, Israel viewed with great apprehension the conflict between the tendencies of protectionism and trade liberalization and recognized the common duty to wage this struggle both internally and in the international arena.

Balance-of-payments position and prospects

6. Members of the Committee expressed appreciation for the comprehensive and informative statement and background material provided by the representative of Israel, and expressed their understanding for Israel's balance-of-payments difficulties which were intimately related to her security expenditures abroad. It was recognized that Israel had followed a policy of trade liberalization since 1962, including the progressive reduction of customs duties and that a further phase of reductions was expected to take place during 1970-75. They welcomed the efforts made by Israel to continue the progressive reduction of quantitative restrictions in spite of the special balance-of-payments situation it faced. They preferred the substitution of tariffs for quantitative restrictions although they noted that the degree of protection afforded by Israel's high tariff was still considerable and the recent protective measures adopted, including the import surcharge, balanced out some of the effects which should have resulted from the liberalization measure. It was hoped that Israel would resume effective liberalization as soon as circumstances permitted.

7. Some members enquired whether in the view of Israel's authorities the large deficit on current account would continue. In reply, the representative of Israel said that total imports of goods and services would increase by almost 15 per cent to reach $3 billion in 1971 while total exports would increase by 14.5 per cent to $1.5 billion. This larger deficit would be due notably to the sharp increase in the importation of ships and aircraft amounting to $150 million. The deficit for services would fall slightly in 1971 after a substantial increase in 1970. Transfer payments would be in the order of $650 million with a similar inflow in long and medium-term capital. No change was expected in the reserves of the Bank of Israel and the level of debts should be about $3.5 billion at the end of this year. For the years 1971 to 1975, the most pressing problem would be the financing of the deficit on current account. It was estimated that the aggregate deficit for these five years would reach $5.8 billion and that the net transfer payments and capital movements would be around $6 billion. For 1972, a slight reduction in the current account deficit had been forecast, based on the expectation of a sharp increase in exports and a moderate increase in imports.

The average annual growth rate for exports should be almost 14 per cent while a 6 to 7 per cent growth rate was forecast for imports. The current account deficit forecast for 1975 was $900 million with exports of goods and services reaching $2.5 billion and imports of goods and services $3.4 billion.

8. A member of the Committee wished to know the reasoning behind Israel's forecast of a rise in exports. The representative of Israel explained that during the past ten years the average annual growth of exports had been slightly less than 15 per cent and it was felt that the same rate could be maintained during the next five years, although the growth rate would not necessarily be constant; for example, exports had increased by only 7 per cent in 1970 but a 20 per cent increase was expected for 1971. Basically, projections for Israel's exports in the next five years were based on an evaluation of both supply and demand conditions. Regarding supply, plans for new investment and expansion of existing export capacity had been put into effect in 1969 and 1970 and should start bearing fruit in 1971. Moreover, exports of the diamond industry - which accounted for 30 per cent of Israel's exports - had declined by 7 per cent in 1970 but were expected to increase in 1971. On the other hand, exports of citrus fruit - which accounted for 20 per cent of Israel's exports - had increased in volume in 1970 but returns had been affected by low market prices. This season, however, there was a substantial increase in the revenue from citrus fruit exports. High earnings were anticipated in 1971 for citrus fruit and diamond exports which together accounted for 50 per cent of Israel's total exports. However, in the future, citrus fruit exports would expand at a lower rate because fewer new groves had been planted.

9. Regarding the remaining 50 per cent of exports it would appear that one could place legitimate expectations on a number of sectors such as the textile industry including hosiery and fashion goods. However, the industries most likely to raise export revenue in the coming five years were those based on technological and scientific know-how. Thus, in 1970, exports of electronic and electrical appliances reached $17 million as against less than $5 million in 1968, and should increase to $75 million in 1975. These efforts had been encouraged for the past three years by the Government with the intention of developing this sector into a major export industry. Agricultural machinery and fertilizers based on potash and phosphate were being exported in increasing quantities to East African countries. Regarding services and specifically tourism, Israel now received half-a-million tourists a year and expected to attract more in the coming years. Summing up, the representative of Israel stated that the country had good reasons for expecting exports of goods and services to increase - its industrial exports rising at a faster rate than traditional agricultural exports.

Alternative measures to restore equilibrium

10. Members of the Committee noted that since the last consultation with Israel a large number of measures had been taken in both the fiscal and monetary fields to reduce demand pressures. Members fully appreciated Israel's difficulties and recalled that the reserves of the country only covered the value of imports for two months. In response to a question, the representative of Israel said that the monetary and fiscal measures taken should be adequate to control anticipated

pressures on Israel's foreign exchange reserves. The growth rate of demand for consumer goods should not exceed 5 per cent for the next two years and it was hoped that import demand for other goods could be controlled by measures already taken.

11. One member asked whether the "package deal", concluded in February 1970, between the Government, the manufacturers and the trade unions to stabilize domestic prices, would be continued beyond the two-year period for which it was concluded. In reply, the representative of Israel said that the Government was under continual pressure to loosen the present restraints on wages and that the "package deal" would be examined and discussed between the parties in the course of this month. He also noted that the Government hoped that discipline would prevail and that there would be no need to introduce new restraints.

System and methods of restrictions

12. One member stated that according to information received by his government the Israel authorities sometimes encouraged Government departments and State finance corporations to promote exports at the time when they place their orders abroad by requiring suppliers to accept Israeli goods in payment up to a certain percentage of the contract value. This form of trading was considered contrary to liberal trade practices and detrimental even to the sound growth of Israel's economy as a whole. The representative of Israel replied that his Government had never given any instructions of this nature. It was, however, current practice all over the world for purchasers of large items such as capital goods, ships, aeroplanes etc. to urge the suppliers to sub-contract to local firms on comparable conditions wherever possible, and the Government encouraged this practice. However, importers were free to purchase from any source; the Government would do no more than to draw the attention of Israeli firms to the fact that foreign suppliers might find part of what they needed in Israel.

13. The representative of Israel assured the Committee that the automatic licensing procedure was indeed automatic and was not operated in a discriminatory manner with respect to country of origin.

14. In response to questions concerning the system of tax refunds, the representative of Israel informed the Committee that since August 1970 these refunds had been increased to offset the impact of the new 20 per cent import surcharge. The current rate of tax refunds was based on four categories of domestic value-added content:

	Refund		
	Argot per US$ of exports	Estimated % of f.o.b. export value	
Category 1 (added value 0-24%)	70	0	+ 20% surcharge
Category 2 (added value 25-44%)	80	3%	+ 20% surcharge
Category 3 (added value 45-64%)	90	6%	+ 20% surcharge
Category 4 (added value 65% and over)	105	10%	+ 20% surcharge

Tax refunds were made on industrial goods and a limited number of agricultural goods. It was impossible to relate the tax refunds to the exact values added. Therefore, to simplify procedures, the tax refunds were divided into four broad categories. As a result of this procedure Israel exporters complained that they were being refunded less than what they actually paid in taxes.

15. In reply to a question on credit facilities for exporters, the representative of Israel said that there had been a 5 per cent increase in subsidized credit for exports. Credit was granted at a rate of 6 per cent when proof of the delivery of the foreign currency to the country was given. At the same time the Government had tightened its control through the banks over foreign exchange receipts. It is doubtful that the subsidy of credit actually contributed to the increase of exports since it only gave Israel exporters credit terms closer to those available to their competitors.

16. Members of the Committee expressed regret that the import deposit scheme had been extended, although they noted that the rate of deposit had been reduced. They expressed the hope that the scheme would be abolished as soon as circumstances permitted and asked if there was any set date for its removal or whether there were any plans for phasing it out. The representative of Israel replied he hoped it would be removed by 31 December 1971, the scheduled expiration date; the scheme did not discriminate between sources of supply.

17. In reply to a query concerning the composition of the Public Committee responsible for examining requests of manufacturers for import relief, the representative of Israel stated that it was composed of representatives of Chambers of Commerce, the Manufacturers' Association, the trade unions and the Ministry of Commerce and Industry. Manufacturers seeking import relief were required to fill in a standard form so that when the Public Committee met to consider the request, the relevant information would be available. At Committee meetings importers' interests were represented by the Chamber of Commerce. The requests were examined in the context of the industry as a whole and always concerned problems connected with import liberalization. In the past two years no quantitative restrictions had been re-introduced in consequence of any such enquiry. In about one out of ten cases some tariffs had been raised on a temporary basis. The Public Committee had not considered any requests since August 1970 after the 20 per cent surcharge had been introduced.

18. Members of the Committee observed that Israel had, since the last consultation, terminated one more bilateral payments agreement and expressed the hope that the four remaining agreements would be terminated as soon as possible. The representative of Israel replied that the remaining four bilateral payments agreements covered only 1 per cent of Israel's total trade. He expressed the opinion that in the case of many countries having centrally-planned economies this was the only possible way of trading and it had therefore been adopted by many contracting parties in their trade relations with these countries.

Conclusions

19. The Committee welcomed the various monetary and fiscal measures that had been taken by Israel in the past two years and expressed the hope that the efforts to restrain the growth of internal demand would continue to be successful, so that the pressures on the balance of payments would be sufficiently reduced to enable the early resumption of the process of effective trade liberalization. In the meantime the Committee hoped that the import deposit would be further reduced and would be abolished as early as possible before the end of 1971. Members of the Committee welcomed the progress that had been made in the termination of bilateral payments agreements and hoped that this trend would continue.

II. TEMPORARY IMPORT SURCHARGE

20. In accordance with the instructions of the Council the Committee, in the course of the consultation on import restrictions, also examined the temporary import surcharge introduced by the Government of Israel in August 1970 as notified to the CONTRACTING PARTIES in L/3433 and Add.1 (see also C/M/64).

21. The representative of Israel referred to the circumstances, described in document BOP/114 and discussed in Section I above, which had led to the introduction of this measure. As stated in document L/3433/Add.1 and BOP/114/Add.2 the order imposing the surcharge, which came into force on 16 August 1970, provided that a 20 per cent surcharge on c.i.f. value was to be levied on all imports into Israel with the exception of some ninety specified items, mainly essential foodstuffs, fuel, ships, aircraft, amounting to less than 15 per cent of total imports (see list in BOP/114/Add.2). The surcharge was levied on imports from all sources without distinction as to country of origin. It was originally to be in force until 31 December 1970 but this had now been extended to 31 March 1972. It was the intention of the Israel authorities to review the situation before that date.

22. In the course of the discussion the representative of Israel explained that the choice of this measure had been motivated partly by a desire to contain domestic inflation through the absorption of excess liquidity in the economy, for which purpose the existing import deposit had been found insufficient. The ratio of 20 per cent had been decided upon for its optimal effect in this regard. The trade effect of the measure might be gauged from the fact that, while imports had been rising at an annual rate of 15 per cent during the first seven months of 1970, the increase for the year as a whole was only 8 per cent.

23. A member of the Committee, referring to the series of recent measures taken by Israel - the continuation of the import deposit, the slowing down of the liberalization process and the import surcharge - enquired whether in the view of the Israel Government the causes of Israel's trade imbalance were as temporary in nature as the measures it had prescribed to relieve the pressure on the balance of payments. The representative of Israel replied that since by far the most important element in the pressure on the country's foreign exchange resources related to security requirements, a change in the political situation could have a tremendous effect on the country's external financial position. At any rate the Israel authorities at present believed that the import surcharge could be discontinued by the end of March 1972.

24. The Committee took note of the advice given by the IMF as quoted in paragraph 3 above, which indicated that:

> "At the present time the general level of restrictions and the import surcharge of Israel which are under reference do not go beyond the extent necessary to stop a serious decline in its monetary reserves."

25. The Chairman of the Committee pointed out that since the surcharge was applied at 20 per cent ad valorem, on a wide range of imports and for a duration of nearly twenty months, it could hardly be said that it would have a limited incidence on imports as had been the case with a similar measure of another contracting party earlier examined in the Committee. The Committee, however, took note of Israel's contention that the import surcharge, as it was at present applied, was less restrictive of trade and less detrimental to the trade interests of other contracting parties than the additional quantitative restrictions that Israel would have been justified in applying under the criteria of the relevant GATT provisions.

26. Taking into account the assurance given by the Israel authorities that the measure would be maintained only to the extent necessary for the specific purpose mentioned above, and would be eliminated as soon as it was no longer justified on that ground, and that it was not designed to provide protection for any particular branches of production, the Committee came to the conclusion that the Council might again wish to take a decision to take note of the situation and keep it under review, and to examine without delay any change in the import surcharge that might be notified by the Government of Israel. The Israel Government should be invited to notify the CONTRACTING PARTIES in advance of any change in the level or duration of application of the import surcharge. Israel should be urged to eliminate the measure as early as circumstances permitted, in any case not later than 31 March 1972. It might also be agreed that the use of this surcharge by Israel should be subject to all the conditions and criteria embodied in the appropriate provisions of the General Agreement governing the use of quantitative restrictions for balance-of-payments reasons. This disposition by the Council would in no way preclude recourse to the appropriate provisions of the General Agreement by any contracting party which considered that any benefits accruing to it under Article II of the Agreement in respect of any bound items included in the Israel Schedule were nullified or impaired as a consequence of this measure.

27. The representative of Japan recalled the statement made by his delegation at the Council meeting on 2-3 December 1970 in connexion with the import charge applied by another contracting party and its contention that the disposition taken by the Council in that case should not be regarded as a precedent for future cases (C/M/65). Likewise the present case should not be regarded as a precedent. The Committee agreed to have this view recorded in its report and wished to stress that the conclusions set forth in paragraph 26 above were formulated after careful consideration of the particular circumstances and merits of this case, and were not intended for application in other instances in the future.

ANNEX

Opening Statement by the Representative of Israel

This Committee by its very nature serves as the "confessional" for countries who are in deep balance-of-payments troubles. All those who are in the habit of consulting in GATT, including ourselves, have for many years been pouring out their tales of woe into the long-suffering ears of the members of the Committee, a tale replete with endless statistics on deficits, debts and other disasters.

The yawning gap of $1.3 billion - or 50 per cent of our total import bill on goods and services for 1970 - dwarfed any economic problem we have had to face before and presents an awesome challenge to the country's economic leadership.

Nothing could be done to save on the $750 million - nearly one third of total foreign exchange expenditure - spent on security. Neither could the Government consider even for one moment defaulting on the payment of principal and interest in regard to its foreign debt to the tune of $450 million in 1970. At the same time we were resolved to continue our policy of dynamic economic expansion, and if possible to speed it up, since we are convinced that this is the only way in which we can achieve eventual economic independence.

Therefore the cardinal question was: how to make ends meet? How to stop the rapid deterioration in the external payments position and still continue with a liberal expansionist policy? The Government was faced with an agonizing choice between two unpalatable alternatives: the first was a return to restrictive administrative control with all its inherent bureaucratic waste, discrimination and distortions. The second was the imposition of new and more stringent fiscal and monetary demands on the already overburdened public.

There were some who felt that administrative controls would be less painful and more effective since direct and indirect taxes had already reached staggering proportions. However, I do not have to tell this Committee why we decided nevertheless against such a course. Instead, as you know, the Government introduced a series of severe fiscal and monetary measures in addition to the ones which we reported to the Committee twelve months ago. At that time, to name just a few of the steps then taken, we introduced the import deposit scheme, we raised the defence levy from 10 to 15 per cent of the value of income tax paid and we increased employers' and employees' contributions to social insurance.

In August 1970, it became evident that these measures were insufficient by themselves to restrain the outflow of foreign currency which was by then reaching dangerous proportions. Therefore, in that month, the Government had to take a new series of emergency measures. As my colleague reported to the

Council on 29 September 1970, these measures included: "an increase in tariffs on a number of items not bound in our schedule in GATT; an increase in purchase tax on a wide range of goods and services; an increase in the travel tax; an increase in excise taxes; higher charges for postage and telephone, higher rates of corporate income tax and capital gains tax, and a curtailment of food subsidies". Apart from these new taxes and fiscal changes, stringent actions were taken in the monetary field. Finally a 20 per cent surcharge was imposed on the majority of imports.

As a result of all these measures the expansion in imports of consumer goods was brought to a halt. However, total imports for the whole of 1970 rose by more than 8 per cent and it is anticipated that imports during the current year will expand by at least the same figure. In other words, Israel continues to provide a growing market for the exports of her trading partners.

I am pleased to inform you, Mr. Chairman, that not only did we refrain from the re-importation of quantitative restrictions, but, in spite of the critical economic circumstances, we continued with our programme of liberalization from administrative controls. Out of a total import of goods of $1,438 million in 1970, only $42 million of industrial imports were in the "restricted" category, compared with $50 million in 1969 and $63 million in 1968. Thus, although the list of BTN items subject to restriction which appears in Annex I and Addendum I is still a far too lengthy one, its actual trade coverage in relation to total imports is negligible and is declining in importance from year to year. Nevertheless, as we indicated last year, we had hoped that progress in this area would be even faster and we are determined to continue the attack on the remaining restrictions.

So much for our import policy.

However, in the long run the value of our imports will have to be determined by our capacity to pay for them by exports. The incurring of mounting foreign debts and the attraction of foreign investment can only be justified in the long run if they lead to increased export capacity and export earnings and this is in fact the goal of our export policy.

As members of the Committee are aware, on 29 June 1970, after ten years of negotiations, we concluded with the European Economic Community an agreement which is of paramount importance for our national economy - both from the point of view of expansion of exports and for the attraction of foreign investment. As you know, the agreement has been submitted to the CONTRACTING PARTIES and a Working Party has been established "to examine the agreement in the light of the relevant provisions of GATT".

Here I must stress one of the main concerns of our commercial policy: as a small country with few natural resources, our dependence on foreign trade is crucial for our economic development and hence it is vitally important for us to secure access to wider markets.

In this connexion, the expected enlargement of the European Community by the adhesion of the United Kingdom and several other EFTA countries which are amongst our most important traditional export markets raises points of considerable concern to us. For example, two thirds of our exports to these countries which enjoy at present zero duties or very low duties and free access will be subjected to tariff and non-tariff barriers under the present EEC external tariff. Today the EEC and EFTA combined absorb nearly 50 per cent of our total exports.

The next biggest export market for Israel is the United States which last year took 20 per cent of our exports - mainly in the shape of industrial products. Great promotional efforts have been invested in this market, and if we are concerned about growth potential, present developments in the textile field are of vital concern to us.

Obviously the implementation of the General Scheme of Preferences has direct implications for our exports to these markets.

Finally, countries in the Mediterranean area and countries directly accessible through our Red Sea outlet are a growing and potentially important outlet for our exports. Many of our industries are directing these major export promotional drives to these markets where we enjoy advantages of proximity.

Like all of you here we view with great apprehension the conflict between the forces of protectionism and trade liberalization in the world which is being fought out on various levels in each and every one of our countries. There is a tendency, a very understandable one, for each of us to see the negative aspects only of the trade policies of other countries, and to minimize our own transgressions. However, each of us has to wage this struggle, both within his own country and in the international arena.